Content Writing Sample 0004

Title Tag: Australia's Private Debt Market Trending Upwards

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Content:

Australia's Private Debt Market Trending Upwards

Private debt has set sail in Australia – and developers need to climb aboard.

Despite its historically niche role, the private debt and bond sector is rapidly expanding, with a tenfold global increase over the last decade. In Australia, a confluence of COVID, the banking Royal Commission, and favourable economic conditions have resulted in a private credit boom that's changing our lending landscape.

Private credit funds might be the salvation younger, capital-light developers need – especially with reluctant banks, an embattled construction sector, and forecasted cash rate hikes set to make financing more difficult than ever.

An Overview of Privately Sourced Debt

Privately sourced debt is exactly what it sounds like: loans issued by private entities rather than banks or publicly traded entities. It includes different forms of financing, like:

- Direct lending
- Mezzanine financing
- Distressed debt
- Venture debt
- Special situations (think corporate spin-offs, tender offers, and M&As)

Since the GFC, private debt prevalence has sharply increased thanks to a reduction in bank lending activity. S&P Global estimates that the AUM (assets under management) of predominantly private

debt-issuing funds has risen from US$39.9B in 2010 to $412.1B in 2020 – an almost tenfold ascension that underscores just how fast the private debt market is maturing.

Just as importantly, dry powder – capital committed by investors that has not been allocated to loans – is piling up, rising from 30.6% of AUM in 2019 to 35.8% in 2020. In contrast to the rising lending conservatism of banks, private investors are hungry for more, and it's a trend that's slowly making its way to Australia.

Australia's Privately Sourced Debt in 2022

Australia is a country dominated by banks – at least, until recently. Our COVID-induced recession showed borrowers that borrowing from banks was, often, a less-than-ideal option characterised by unfavourable loan conditions and poor flexibility. Banks were also notoriously less willing to supply funding, especially for SMEs.

Without large-scale alternatives to bank credit for borrowers to fall back on, the Australian private bond and debt sector has grown to somewhere between $109B and $1.8T over the past three years (different studies provide different estimates). Boutique private debt firms are being founded at record rates, but multinationals like Ares Management are also establishing Australian beachheads, giving borrowers a viable alternative to banks.

That growth isn't going away anytime soon, either. With the RBA's Australian bond-buying program drawing to a close and inflation forecasted to rise 3.25%, investors will be seeking shelter in safe havens – which means committing more capital than ever to private debt funds, where the floating rates of the underlying loans will insulate them from fallout.

Although private debt still comprises a relatively small percentage of overall bonds and debts in Australia, it's no longer huddled in the corner. With unprecedented growth and strong uptake, this is a sector confidently marching towards the limelight – and that's good news for borrowers who want a viable alternative to the drawn-out, often unfruitful bank loan process.

What Current Trends Mean for Developers

In a previous article, we talked about how private lending can make smaller residential developments viable. Developers without extensive track records or capital are likely to be rejected by banks looking for security; even if a loan is on the table, most banks require that at least 80% of the funding is covered by pre-sales, which can chew into project profitability.

Private lenders, on the other hand, offset their risk with higher interest rates, so they're more willing to lend to younger, capital-light firms without requiring pre-sales. This can make private debt an attractive option – especially for developers confident in their project's success.

And the current trends in Australia? All that dry powder – with more to come, if the RBA's forecast holds steady – means that the private debt market will become even more saturated, resulting in lenders actively competing to allocate debt. That could create more favourable loan conditions, especially if the waves of international private funds keep coming.

The comparison to bank loans is stark. With the triple impacts of COVID, ARPA lending guideline changes, and the banking Royal Commission, banks are less likely than ever to issue loans for developers.

But that doesn't mean waiting around for the private debt market to get even better is a good idea. While continued growth is near-certain, the interest rate is also set to increase. Despite the RBA's insistence that "ceasing purchases under the bond purchase program does not imply a near-term increase in interest rates", CBA is predicting an interest rate hike of about 1% as early as June 2022.

For developers currently considering funding options, securing financing in the next three months could mean the difference between a profitable project and a Pyrrhic delivery. For certain projects, locking in favourable interest rates could actually be worth it, even if a full project pipeline means holding onto the property for longer than normal.

Securing funding before June won't be the right move for every developer. But, with private loans increasing project viability and interest rates at an all-time low, it's definitely something to think about.